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appointee

**Advice & Consent Questions: For State Treasurer Nominee**

1. If revenues fail to meet expectations and revenue enhancements become an unavoidable necessity how would you recommend that revenues be enhanced? Which taxes would you recommend be increased first? What events would make tax increases unavoidable in your opinion?
2. Describe for us the State Streamline Sales Tax Agreement that the State has recently signed on to. What are its major advantages to Michigan? What changes do we need to make in tax acts to implement the agreement? What is your timeline for enacting those changes? What are the expected revenue impacts going to be?
3. During the campaign the Governor said that she wanted to replace the Single Business Tax. How soon do you expect to begin formal discussions concerning a proposed replacement tax for the Single Business Tax? What type of tax is it going to be, a profits tax, a gross receipts tax, etc? Will it be revenue neutral or will there be a change in expected revenues? The Single Business Tax was designed to provide fairly even revenues in bad economic times as well as good. As you know, most other business taxes tend to go up when the economy is improving and down when the economy is deteriorating. Considering the current economic conditions, and the fact that Michigan's economy traditionally swings up and down more dramatically than the nation's economy as a whole, do you think that the new business tax needs to be designed to provide stable revenues? If so, how would you suggest that be done?
4. As you know, probably one of your biggest responsibilities as Treasurer is the fiduciary responsibility of investing all the state's money, especially public employees pension funds. Do you have a new strategy in mind to improve the investment returns on the state's investments? Given the problems with corporate bookkeeping practices, the unreliability of some accounting firms' audits, and the questionable practices of investment firms and brokerage houses, how do you intend to assure that your information is reliable?
5. Do you believe in socially responsible investing, that is avoiding investments in companies that might be drilling for oil in the Arctic National Wildlife Refuge, German companies that used slave labor during World War II, or companies doing business with the government of Iraq? How much of an activist should the state treasurer be? Closer to home, do you feel that pension funds should be used specifically as part of a strategy to stimulate economic development in Michigan? If so, how? Can you tell us how profitable the Michigan development investments made by the Blanchard Administration have been?
6. As you know, in 1990 the state's credit rating was AA. It has been AAA since 2001. Never before has it been this high. Only 10 other states have this top rating. The improvement in the credit rating was due in no small part to the large surplus in the Budget Stabilization Fund, which is now gone. Do you expect the state's credit to be down graded? If so, by how much? Can you tell us what the fiscal impact is on the state's borrowing for things like transportation bonds, for a drop in AAA to AA? What steps are you going to take to keep the state's rating as high as possible? How would you assess the trade-offs between building up the BSF quickly in order to maintain our credit rating, given that once there is over \$250 million in the BSF the Single Business Tax rate begins to drop again?
7. Should the MEAP office remain in the Treasury Department? Why or why not? Do you feel that the merit scholarship program should be means tested in some fashion?

8. Having previously served as deputy director what are the three most important challenges you would anticipate managing in the Department of Treasury in your first year as Treasurer? What changes do you envision?

9. What do you view to be the funding priorities for your Department?

10. Given the Governor's recent comments concerning ethics ...how do you intend to handle any problems with vendors or subcontractors?

Responses to Appointment Questionnaire  
Office of the Senate Majority Leader  
Advice & Consent Question for State Treasurer Nominee

1. A situation posited in which "revenue enhancements become an unavoidable necessity" presumes both a consensus determination that revenues have failed to meet expectations, that significant budgetary cuts have been made and that further cuts would cause budgetary reductions of a scale that could threaten basic public services. If such an event occurs, then I would recommend a review of non-tax revenue enhancements and of tax expenditures and loopholes. No specific non-tax revenue enhancements or tax loopholes have been examined to reach a specific recommendation.
2. The legislature technically has not actually authorized the State Streamline Sales Tax Agreement (the "Agreement"). In October of 2001 the Legislature passed the Equitable Sales and Use Tax Administration Act, PA 122 of 2001 (MCL 205.151-167). The Act created an 8 member Board of Governance and authorized those members to represent the State at meetings related to development of the Agreement and to vote on provisions of the proposed Agreement. Those meetings began in November of 2001 and were known as "Implementing States" meetings. Over the course of 2002, the Implementing States held several meetings at which they adopted key provisions of the proposed Agreement. On November 12, 2002 the representatives Implementing States reached a consensus on the terms of the Agreement, although additional definitions are expected to be added and other minor changes are likely as states proceed to pass implementing legislation during 2003.

No states have "signed" the Agreement. That cannot be done until a state passes implementing legislation to bring it into compliance with the terms of the Agreement. Once that legislation is passed a state will need to submit a certificate of compliance to the co-chairs of the Implementing States. The Agreement becomes effective when at least 10 states comprising at least 20% of the total population all of states imposing a state sales tax have petitioned for membership and have been found to be in compliance with the Agreement. The Agreement takes effect after the tenth state is found to be in compliance but cannot take effect prior to July 1, 2003.

Upon its effectiveness, the main focus of the Agreement is to provide improved sales and use tax administration systems for traditional retailers and remote sellers (catalog and Internet sales), while retaining a state's existing tax base and exemptions. Key provisions of the Agreement are uniform definitions, rate simplification, uniform sourcing and audit procedures, and helping to reduce the financial burden on sellers who participate under the Agreement. The Agreement sets out the provisions that must be reflected in state statutes, regulations or other authorities in order to bring about simplification and uniformity of state sales and use tax systems. By implementing the Agreement, Michigan hopes to increase voluntary use tax collections simply by reducing sellers' compliance burdens. The Agreement will also provide an impetus to Congress to allow the collection of use taxes on internet and mail order sales that have been subject to tax under Michigan law since the 1930s.

It is difficult to estimate the fiscal impact of the Agreement. The Office of Revenue and Tax Analysis estimates that for FY 2001 Michigan lost \$156 million in tax revenue from mail order sales and \$54 million from internet sales, for a total loss of \$210 million. That amount is expected to grow significantly in the coming years.

3. I will immediately start a review of the incidence, cyclical effects, and economic impact of the SBT and modeling alternatives to the SBT. With this information, we will seek to engage the business community and state tax experts to explore and discuss how a replacement to the SBT should be developed which values revenue stability, discourages tax-based business decisions, maintains a competitive tax structure for Michigan, and allocates a fair portion of the cost of the State's economic infrastructure to businesses. The objective of this process is to improve the State's business tax structure and system, not to initially generate additional revenues.

4. As fiduciary of the various public employee pension funds, my first obligation with respect to the investment of the assets of these funds is to maintain strict compliance with 1965 PA 314 (MCL 38.1133) which states in part:

“An investment fiduciary shall discharge his or her duties solely in the interest of the participants and the beneficiaries, and shall do all of the following:

(a) Act with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity and familiar with those matters would use in the conduct of a similar enterprise with similar aims.

(b) Act with due regard for the management, reputation, and stability of the issuer and the character of the particular investments being considered.

(c) Make investments for the exclusive purposes of providing benefits to participants and participants' beneficiaries, and of defraying reasonable expenses of investing the assets of the system.

(d) Give appropriate consideration to those facts and circumstances that the investment fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the system's investments for which the investment fiduciary has responsibility; and act accordingly. For purposes of this subsection, “appropriate consideration” includes, but is not limited to, a determination by the investment fiduciary that a particular investment or investment course of action is reasonably designed, as part of the investments of the system, to further the purposes of the system, taking into consideration the risk of loss and the opportunity for gain or other return associated with the investment or investment course of action; and consideration of the following factors as they relate to the investment or investment course of action:

- (i) The diversification of the investments of the system.
- (ii) The liquidity and current return of the investments of the system relative to the anticipated cash flow requirements of the system.
- (iii) The projected return of the investments of the system relative to the funding objectives of the system.

(e) Give appropriate consideration to investments that would enhance the general welfare of this state and its citizens if those investments offer the safety and rate of return comparable to other investments permitted under this act and available to the investment fiduciary at the time the investment decision is made.”

In conformance with these statutory principles, as otherwise limited by Act 314, I will encourage the Bureau of Investment to maintain its policy of regularly reviewing asset allocations to optimize risk-adjusted returns while continuing to develop enhanced valuation, screening, and portfolio management tools and applications. These systematic and structured decision making processes will foster a greater likelihood for enhanced returns as investor confidence and the economy slowly recover and in the face of uncertainty added by geopolitical risks.

The failure of corporations and their auditors to accurately report their results and in assuring a separation between the product and analytical lines of investment banks and money managers threatens the ability of the Bureau of Investment to optimize returns and prudently manage funds. In an effort to mitigate this risk, the Bureau of Investments has sent letters to all brokers/investment bankers as well as outside money managers with whom the Bureau of Investments does business, requiring adherence to the “Merrill Lynch Investment Protection Principles” and will develop a program for monitoring and compelling compliance with these Principles. In addition, the Bureau of Investments has recommended that the Office of Retirement Services obtain the same compliance from defined contribution fund managers. These Principles will specifically require that investment banking/brokerage firms:

1. Sever the link between compensation for equity research analysts and investment banking.
2. Prohibit investment banking input into analyst compensation.
3. Create an independent review committee to approve all research recommendations.
4. Require that, upon discontinuation of research coverage of a company, firms will disclose the coverage termination and the rationale for such termination.
5. Disclose in research reports whether the firm has received or is entitled to receive any compensation from a covered company over the past 12 months.

6. Establish a monitoring process to ensure compliance with the Principles.
7. Prohibit promises of favorable research.

As for the “Michigan development investments made by the Blanchard Administration”, I have no records available to provide a response to this question.

5. As stated above, the investment criteria are governed by the requirements of Act 314 and all investment decisions will be measured by that fiduciary standard. Purely social investment criteria are legislatively created and, in that regard, the development of policies that “give appropriate consideration” to Michigan based investments enhancing the welfare of the State is specifically required by Act 314 if such investments present comparable risk-adjusted returns. I will follow these statutory principles in establishing a Technology Tri-Corridor investment initiative for Michigan. At this time I am not prepared to discuss the exact structure of this initiative. I will also follow these statutory principles to actively manage pension fund investments and will make responsible decisions on a fiduciary basis, including voting against management recommendations where necessary and appropriate.

6. In my experience the municipal bond rating agencies do not lightly confer or withdraw a AAA rating. Michigan’s AAA rating by Moody’s and Standard & Poors reflects both the underlying strength of the State’s economy and management conviction as to sound financial practices. Michigan has placed itself in a challenging financial position for FY 2003-04 and the delays in addressing the revenue and expenditure practices have exacerbated the problem before us. Past surpluses in the Budget Stabilization Fund have provided security for the rating and allow time to address the challenge without panic. If the State acts in a manner to resolve the structural deficit on a more permanent basis and a economic recovery does not show a structural weakness in Michigan’s economy, I believe a strong case will be made for maintaining our AAA ratings.

An adequate Rainy Day fund is, of course, an important element in exhibiting the financial stability expected of a AAA State. As in past years, voluntary deposits into the BSF that may result in a reduction of the SBT rate and revenues will need to be weighed against the appropriations approved by the Legislature.

With respect to the fiscal impact of a General Obligation rating upon transportation bonds, it must be understood that the restricted revenues pledged to repay transportation bonds are not evaluated in the GO rating. Conversely, it is true, however, that various factors related to the state’s economy that effect the GO rating will also impact a rating received upon transportation bonds. A significantly greater impact of a GO rating decrease would be felt by local school districts issuing qualified school bonds and by property owners who will experience greater property tax bills to pay the higher levies needed to service higher interest costs.

7. The Governor has indicated her intention to transfer the MEAP office and the merit scholarship program to the Department of Education. Standardized testing is an integral part of the kinds of curriculum development functions performed by the DOE. While there has been an

ongoing, cooperative relationship between the MEAP staff and DOE staff, efficiency would be improved if both programs had common management. Moreover, those programs and issues related to them are education policy issues appropriate for others in the Administration.

8. I believe the 3 greatest challenges facing Treasury are the maintenance of the State's credit rating, stemming local fiscal crises looming or on the verge of developing in various municipalities around the state, and in adoption of Streamline Sales Tax Agreement and Congressional action to permit collection of use taxes on internet and mail order sales.

These specific challenges should not overshadow the ongoing significance of management of the Retirement Systems and increasing revenue collection during the next year. Such day-to-day business of Treasury is critically important. We process approximately 6.6 million individual income tax returns, providing annual refunds totaling \$1.5 billion. During the year we answer over 1 million phone calls; more than 800,000 of them regarding individual income tax. On the business side, we process 3.6 million tax returns and register 26,000 new businesses annually. We provide all the State's banking services and collect delinquent debt for all Departments. Keeping the airplane flying is going to be a challenge and a priority equally as important as putting out the fires that inevitably occur.

9. Treasury has always been an efficiently run organization. We process an extraordinary amount of data and information very quickly and with minimum resources. This is due largely to significant efforts to eliminate paper - almost 40% of our taxpayers file in non-paper form and a variety of our banking transactions are handled electronically. For example 67% of all dollars paid by the State are via EFT - electronic funds transfer; 70% of all state employees received their pay checks via direct deposit; and 23% of income tax refunds are direct deposited. So one priority will be to continue these efforts to modernize our services. Other funding priorities will be to adequately staff customer service and tax collection functions. These two areas are vital to Treasury's core missions - assisting the vast majority of taxpayers who file accurately and timely and pursuing those who don't.

10. While employees at all of Treasury's Bureaus are held to high ethical standards, the Bureau of Investments is one area in which extraordinary effort is taken to convey a clear understanding of, and require compliance with, particularized ethical standards to employees that include the Association for Investment Management and Research (AIMR) "Code of Ethics and Standard of Professional Conduct". This Code includes restrictions upon buying or selling securities for the employees account or the account of members of the employee's family.

Treasury's other major function, processing taxes, brings all who deal with our data into the world of extreme confidentiality. Our contractors and vendors are subject to rules of engagement required by the IRS, which provides a layer of review in addition to our own.

Personally, in addition to compliance with all relevant laws related to conflicts of interest and incompatibility of office and to Executive Directive 2003-1, I will recuse myself from participation in a decision that could involve selection of my former law firm to represent the State or any State Authority and will comply with Rule 1.11(c) of the Michigan Rules of Professional Conduct which provides, in part:

Except as law may otherwise expressly permit, a lawyer serving as a public officer or employee may not:

- (i) Participate in any matter in which the lawyer participated personally and substantially while in private practice or non-governmental employment, unless under applicable law no one is, or by lawful delegation may be, authorized to act in the lawyers stead in the matter . . .